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Summary

Weak US data and lingering uncertainty about the timing and consequences of tapering of Quantitative Easing (QE) in the United States triggered a sharp sell-off in a number of markets over the past week. The violence of the moves, including the re-pricing of some part of the Emerging Markets universe, the fact that these moves were triggered by non-Emerging Market events, and the absence of significant fundamental changes in the Emerging Markets suggests to us that significant value is now being created in Emerging Markets. In other words, this is a near replica of the sell-off in May 2012, which also went on to handsomely reward those investors who bought into the dip.

Global

US stocks are now 3.6% off their peak following increased talk of tapering of QE by Fed officials. The decline in equities suggests that the market is not confident about the ability of the US economy to sustain positive growth momentum in the absence of continuing 'life support' from Fed purchases, thus calling into question both the rationale for the recent strong US equity market rally as well as the credibility of the Fed's recent rhetoric about tapering.

Meanwhile, the other highly speculative developed markets to experience sharp recent reversals were Japanese stocks (down 16.5% since early May) and USDJPY (down 4% over the same period). DXY, the index which measures the value of the Dollar against mainly other developed currencies, weakened over the past week and is now down 2.2% from the highs. EURUSD was up 60bps over the past week.

Brent oil prices rose about 1%, and VIX, the equity volatility index, surged to 17.50.

Despite the weaker sentiment, US 10yr yield fell only marginally to 2.08% as the market weighs the Fed's next move. In terms of fundamentals, US data was on balance weaker in the past week. Notable disappointments included ISM manufacturing (49 versus 50.7 expected), private payrolls (135K versus 165K expected), factory orders (1% versus 1.5% expected), and unit labour costs (-4.3% versus +0.5% expected).

In light of the recent weakness in US data, the key focus for the rest of this week will be tomorrow's non-farm payroll release and how the Fed's rhetoric may or may not change in response to this number. In other news, the Obama Administration announced that a grand bargain on a long-term solution to the US fiscal problems before the 2014 mid-term elections is now off the table, and European PMI's marginally beat expectations, particularly in the periphery economies.

Latin America

Brazil: In the past week, the Brazilian government scrapped the financial transactions tax for foreign investors entering the local bond market. The tax cut (from 6% to 0%) follows 75 basis points of rate hikes over the past two months by the central bank. We regard these twin developments as very positive, particularly since they have taken place against a backdrop of relatively weak growth. This illustrates the high priority attached to maintaining control of inflation (and hence macroeconomic stability) by the Brazilian government. Meanwhile, Brazilian industrial production increased at a sharper than expected rate of 1.8% mom in April.

Venezuela: GDP in Q1 was very weak at just 0.7% as the government prepares for the first road show to see international investors in several years.

Colombia: Colombia's central bank left rates unchanged at 3.25% and maintained the current level of intervention to prevent excessive appreciation of the currency. Unemployment dropped from 10.9% in April 2012 to 10.2% this April.

Mexico: PMI rose to 52.9 in May, up 0.3 from April.

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Asia

China: China's official PMI rose to 50.8 in May from 50.6 in April and beat expectations of 50. The currency also continued to strengthen, fixing at a new high versus the US Dollar of 6.1735. The CNY has now appreciated nearly 2% versus the Dollar since the start of the year. Chinese housing prices rose for the 12th consecutive month in May with 77 out of 99 surveyed cities reporting price increases.

India: India embarked on yet another round of easing of restrictions on foreign investor access to the domestic fixed income market as new public sector data showed that the government's fiscal measures, announced earlier this year, are working. PMI was lower than expected.

South Korea: Inflation in May was lower than expected (1% versus 1.2% expected), while exports strongly outperformed expectations (up 3.2% yoy versus -0.9% yoy expected).

Indonesia: Inflation in May was lower than expected at 5.47% (-0.03% mom), but the trade balance widened due to softer exports.

Thailand: The inflation rate declined to 2.3% yoy in May from 2.4% in April.

Taiwan: PMI was lower than expected.

Hong Kong: Retail sales rose at a strong pace of 19.3% yoy in April.

Eastern Europe, Africa, and Middle East

Soth Africa: In comments to the market, South Africa's central bank highlighted inflation risks despite a weak outlook for GDP.

Czech Republic: GDP growth for Q1 2013 was -1.1% versus -0.8% expected, but the drag was mainly due to a significant decline in inventories, which is likely to be reversed in coming quarters, while household spending and exports both rose in the first quarter.

Turkey: Turkish stock markets and the currency weakened sharply in the past week on the back of social unrest in Istanbul. Monthly inflation, however, was sharply lower than expected at 0.15% mom (versus 0.5% mom expected), though inflation continues to move higher in yoy terms (now 6.51%).

Ghana: The government announced that it is scrapping fuel subsidies to ensure fiscal stability.

Poland: Poland's central bank reduced policy rates by 25bps to 2.75% in line with market expectations.

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